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No. 546

In The

SUPREME COURT OF THE UNITED STATES

October Term, 1966

EDGAR I. SHOTT, JR.,
Petitioner,

vs.

THOMAS A. CONROY, Trustee in Bankruptcy for Leslie D. Stickler, Bankrupt,
Respondent.

BRIEF OF RESPONDENT OPPOSING PETITION FOR WRIT OF CERTIORARI

J. VINCENT AUG
S. ARTHUR SPIEGEL
Atlas Bank Building
Cincinnati, Ohio 45202
Counsel for Respondent.

Of Counsel:
WILLIAM H. NIEMAN
1005 Atlas Bank Bldg.
Cincinnati, Ohio 45202

JAMES G. ANDREWS, JR.
205 Atlas Bank Building
Cincinnati, Ohio 45202
Counsel for Petitioner

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Texts Cited:

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Section 1313.56, Ohio Revised Code 4
Section 1313.57, Ohio Revised Code 4

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QUESTION PRESENTED

Whether the granting of Summary Judgment to the Respondent was proper where (1) there was no contested issue of material fact, and (2) the court properly applied the substantive law of the State of Ohio.

THE STATUTES INVOLVED

Contrary to the Petitioner's assertion that the Court of Appeals did not rely on Section 1335.02, Ohio Revised Code, entitled "Gifts and Grants to Defraud Creditors Void," the Court of Appeals not only based its decision on such statute, but quoted it in its Opinion (Petitioner's Brief, page 21), and merely paraphrased Section 1313.56

and 1313.57, Ohio Revised Code. Note Section 1335.02, as set out in the Court of Appeals' Opinion:

> "Every gift, grant, or conveyance of land, tenaments, hereditaments, rents, goods, or chattels, * * * made or obtained with intent to defraud creditors of their just and lawful debts or damages, or to deceive the persons purchasing such lands, tenaments, hereditaments, rents, goods, or chattels, is void."

STATEMENT OF THE CASE

Respondent is the Trustee in Bankruptcy for Leslie D. Stickler, who is seeking to recover from Petitioner, payments made by the Bankrupt to the Petitioner and many others in a "Ponzi" type scheme operated by the Bankrupt, wherein the Petitioner received exorbitant interest or fictitious profits on loans made by him to the Bankrupt. These loans extended over a number of years, involving in excess of six hundred transactions, with interest running from 120% to 360% per annum. As the scheme snowballed, the interest rates or fictitious profits demanded by Petitioner grew as he shortened the period of the "loans." In the last few weeks before the collapse, the Petitioner stopped lending altogether, and took down from the Bankrupt, some $90,000.00 in cash.

The theory of the Respondent's cause of action is that the transfers made by the Bankrupt to the Petitioner were fraudulent conveyances under applicable state law, which the Respondent as Trustee in Bankruptcy, can have set aside and repaid to it. The Petitioner thereupon would have a right, under the applicable provisions of the Bankruptcy Act, to participate on a pro rata basis with others who were part of the fraudulent scheme, on the basis of the amount of their payments to the Bankrupt. The Bankrupt had other creditors of the "butcher, baker and candle-

stick maker" type, who were not participants in the scheme, but who extended credit and lost heavily by reason of the Bankrupt's apparent wealth, generated by the scheme.

RESPONDENT'S MOTION FOR SUMMARY JUDGMENT

(1) There was no contested issue of material fact.

At the Pretrial conference in the District Court, counsel for the Petitioner conceded that no issues of fact were involved:

> "The Court: * * * I take it particularly from the defendant's pretrial statement that there really aren't any issues of fact that are going to present any problem. Is that true?
>
> "Mr. Andrews (attorney for defendant): I don't think there are going to be any issues of fact. There are a lot of things that—
>
> "Mr. John A. Lloyd, Jr., Esq., attorney for defendant, enters the chambers.
>
> "The Court: I had just said before you came in, Mr. Lloyd, that I take it from the pretrial statement that there really are no factual issues here or they don't amount to much. To put it another way, if there are any I think they could be resolved right here, but I frankly don't know what they are.
>
> "Mr. Lloyd: I agree." (App. 12b-13b)

> "The Court: There is no argument on the facts on this point though, that you can establish these facts by stipulation or whatever and then make your respective arguments on the points you are talking about now. Whether or not there is a presumption of fraudulent intent will simply be a matter for the determination of the court. There is no problem created there.
>
> "Mr. Andrews: (Nodding.)" (App. 32b)

Thereupon, as the Court of Appeals noted, the Pretrial Order of the District Court provided:

> "Counsel agree on the desirability of a determination on the issue of liability prior to submission of evidence on the issue of damages. Plaintiff will file a Motion for Summary Judgment on the liability issue, supported by stipulations to the extent possible and supplemented, if necessary, by affidavit(s). If felt necessary to fully present the liability issue, defendant will thereafter file a Cross-Motion for Summary Judgment."

The foregoing was the basis for the filing of the Cross-Motions for Summary Judgment in this action; and as far as Respondent is concerned, there are at least two statutory grounds upon which Summary Judgment should be granted to the Respondent: Section 1335.02, O.R.C., covering fraudulent conveyances, and Section 1313.56 and 1313.57, O.R.C., referring to preferential transfers as well as fraudulent transfers.

These statutes require that the fraudulent intent of the transferor be established. However, Section 1335.02, O.R.C. does not require proof of knowledge on the part of the transferee of the fraudulent intent of the transferor, whereas Section 1313.57 does require knowledge by the transferee.

Thus, the questions before the District Court on the Cross-Motions for Summary Judgment was the determination whether the transferor, the Bankrupt Stickler, intended to defraud his creditors, and if so, then, *first*, whether the Petitioner had actual knowledge of the transferor's intent, *secondly*, if not, whether the Petitioner should have had such knowledge, or, *thirdly*, whether the establishment of actual or constructive knowledge of Petitioner of Stickler's intent is a "prerequisite to recovery."

The basic question involving the fraudulent intent of Stickler and the Petitioner's knowledge thereof is whether the Affidavits of Respondent and Petitioner present a "genuine issue of material fact" under Rule 56 (c) of the Federal Rules of Civil Procedure. This issue must be one of evidentiary fact, not merely as to the legal conclusion to be drawn from the evidentiary facts. *Fox* v. *Johnson & Wimsatt, Inc.,* 127 F.2nd 729, 736-7 (D.C. Cir. 1942). Judge Rutledge, in affirming a Summary Judgment, stated:

> "There was a conflict concerning interpretation of the facts and the ultimate conclusion to be drawn from them respecting intention. But there was none as to the facts themselves. In other words, the evidentiary facts were not substantially in dispute * * *. Conflict concerning the ultimate and decisive conclusion to be drawn from the undisputed facts does not prevent rendition of a summary judgment when that conclusion is one to be drawn by the court. The court had before it, all the facts which a formal trial would have produced. Going through the motions of a trial would have been futile."

See also *Dickheiser* v. *Penn. R.R. Co.,* 5 FRD 5 (D.C. Pa. 1945), affirmed 155 F.2nd 266 (3rd Cir. 1946), cert. den. 329 U.S. 808 (1947); *Heart of America Lumber Co.* v. *Belove,* 28 F. Supp. 619 (W.D. Mo. 1939), affirmed 111 F.2nd 535 (8th Cir. 1940). (On Summary Judgment court determined ultimate fact as to whether building was damaged or destroyed by fire.)

None of the statements of evidentiary fact in Respondent's Affidavits was denied by Petitioner. They must, therefore, under Rule 56 (c), be taken to be true, for the purposes of Summary Judgment.

As the District Judge observed in his Memorandum Opinion, (Petitioner's Brief, Page 29), which was also

adopted by the Court of Appeals (Petitioner's Brief, page 22), the fraudulent intent of Stickler "is not debatable." By the very nature of his "Ponzi" type scheme, every payment involving unconscionable interest or fictitious profits, resulted necessarily in the defrauding of his creditors. In addition, the record made clear that Stickler made false representations that he was "lending such sums to contractors who could afford to pay a substantial return for the short term use of such funds." (App. 27a). No such contractors, of course, existed and no such loans were made. (App. 21a). Petitioner attempted to compare Stickler's operations to the standard check kiting methods sometimes used to cover a temporary shortage of funds, and suggested that Stickler expected to repay the loans out of his income from his law practice. The District Judge clearly disposed of this contention with the comment:

> "It would not seem to overstretch the doctrine of judicial notice to observe that a lawyer may not reasonably expect to repay loans extending into the millions 'from his law practice.'" (Petitioner's Brief, page 32.)

What the Bankrupt said and did is proof of his fraudulent intent, for, as pointed out by Mr. Justice Vinson in *American Communications Association* v. *Douds,* 339 U.S. 382, 70 S. Ct. 674, 94 L. Ed. 925, at page 411: "* * * while objective facts may be proved directly, the state of a man's mind must be inferred from the things he says or does." See also *Radio Officers Union* v. *NLRB,* 347 U.S. 17, 74 S. Ct. 324, 98 L. Ed. 455, at page 45: "* * * the common law rule that a man is held to intend the foreseeable consequences of his conduct. (Citations and other cases in the Supreme Court of the United States omitted.)"

(2) The Court properly applied the substantive law of the State of Ohio.

Respondent submits that under Ohio law, establishment of Petitioner's knowledge of Stickler's fraudulent intent is not necessary to void the transfers at issue. The courts of Ohio have repeatedly held that under Section 1335.02, O.R.C., the knowledge of the transferee of the transferor's fraudulent intent is not material. *Conrad* v. *Sample,* 107 O.A. 66, 156 N.E.2nd 748, 749-50 (1958):

> "In Section 1335.02, Revised Code, there is no requirement that an action brought under favor of that section shall contain an allegation that the transferee of the property, where the transfer is alleged to have been made to defraud creditors, knew of the fraudulent intent of the debtor transferor."

See also, *Burket* v. *Claypool,* 35 O.L.A. 126, 39 N.E.2nd 873; *Ortman* v. *Falknor,* 27 O.L.A. 312 (App. 1938); *Ursak* v. *Sivanick,* 56 O.A. 434, 10 N.E.2nd 1017 (1937).

The District Court, as well as the Court of Appeals, recognized that it was unnecessary to establish either actual or constructive knowledge on the part of the Petitioner, of Stickler's intent as a prerequisite to recovery, when the Court stated: "It is further concluded that the third issue should also be resolved affirmatively to the plaintiff." (Opinion of District Court, Petitioner's Brief, page 34, Opinion of the Court of Appeals, Petitioner's Brief, page 24.)

However, assuming that, *arguendo,* actual or constructive knowledge of Stickler's intent by the Petitioner must be established, it is hard to ignore the statement of Petitioner's counsel at the Pretrial Conference in the District Court:

> "The Court: Mr. Andrews, what would your evidence show that Shott thought Stickler was doing with this?

> "Mr. Andrews: Judge, I attended a meeting at my office one time. I never believed this scheme, and I had conversations with Shott for years about it, telling him to get out of it." (App. 26b).

Moreover, the number and size of the transactions between the Petitioner and Stickler is significant. Petitioner participated in approximately six hundred transactions with Stickler over a period of more than four years, involving over a million dollars. His "investment" was more than twice as large as any of Stickler's other lenders. He also made "loans" on behalf of others. Certainly a reasonably prudent attorney must be charged with knowledge of a scheme in which he was so heavily involved.

Furthermore, such knowledge is clearly indicated by the series of transfers to Shott during the last few weeks before Stickler's scheme collapsed. From December 16, 1960 through January 4, 1961, Shott received almost $90,000.00 from Stickler. The collapse occurred on January 7th, 1961. During the period from December 14th to January 7th, Shott made no more loans to Stickler. An examination of the Shott-Stickler transactions shows such a consecutive series of payments to be unique. Obviously, the Petitioner knew the essential nature of Stickler's scheme and that the pressure of creditors was endangering the operation.

In addition to the foregoing, an analysis of the six hundred transactions between Stickler and the Petitioner, according to the Affidavit of the Certified Public Accountant who reconstructed Stickler's operation, points out the grossly inadequate consideration that Stickler was forced to pay Petitioner for the use of his money:

> "According to Mr. Stickler's records, the interest varied from 120% per annum to 360% per annum. On a cumulative basis, according to Mr. Stickler's records, Shott loaned Stickler $1,020,510.00, received

> back as principal $969,000.00, and interest $394,410.00, for a total of $1,363,410.00. Stickler's records disclosed that $51,510.00 in principal is still owed Shott. If interest had been calculated at the maximum legal rate of 8% per annum, on a daily basis balance for the total period of Shott's dealings with Stickler from September, 1956, Stickler should have paid $21,212.57 as interest, so that the *excess interest or profits or consideration paid for the use of Shott's funds was $373,197.43.*" (Emphasis added.) (App. 19a).

Only the most naive would have invested more than a million dollars in such a scheme without recognizing its nature, and the Petitioner was not such an investor. Rather, he did recognize the scheme for what it was and the possibilities for profits therein. In any event, as noted by the Court of Appeals, the Petitioner received $342,900.00 more from Stickler than he loaned him.

Although it was not necessary for the courts below to consider whether Shott had knowledge of Sticklers intent, both the District Court and the Court of Appeals found that at the very least Petitioner "is charged with constructive knowledge of the fraudulent intent of the Bankrupt under facts which are not disputed. * * *" (Opinion of the Court of Appeals, Petitioner's Brief, page 25.) Ohio case law establishes that constructive knowledge is sufficient: *Loudenback* v. *Foster,* 39 O.S. 203 (1883); knowledge inferred from circumstances of sale: *Blackford* v. *Gaynor,* 50 O.A. 494, 198 N.E. 736 (1934); the court recognized that knowledge of fraudulent intent could be inferred from inadequacy of consideration: *Burbridge* v. *Seely, Morely* & *Co.,* Wright 359 (1833); knowledge inferred from retention of possession: *Lyons, Trustee* v. *Riker,* 29 O. Law Reports 324, 325 (U.S.D.C., N.D. O., 1929): "Likewise, Riker had knowledge of facts such as must charge him with knowledge of Smith's insolvency, and having

participated in that intent to create a preference;" *In re Lee,* 129 F. Supp. 920 (N.D. O., 1955). Note *Veazie* v. *Williams,* 8 Howard 134, 12 L. Ed. 1018, to the effect that inadequacy of price may be so gross as to raise the presumption of fraud.

Therefore, the Courts below properly applied the substantive law of Ohio to the undisputed facts disclosed by the pleadings, affidavits and other material before the Courts below.

REASONS FOR DENYING THE WRIT

It is submitted that the decision of the Court of Appeals is not in conflict with that of any other Court of Appeals or with this Honorable Court, nor was the decision of the Court below in conflict with the substantive law of Ohio.

Simply stated, the District Court determined that there were no genuine issues of evidentiary fact to be determined in this case. Counsel for both parties agreed with the Court that it was for the Court to determine the legal inferences to be drawn from the undisputed facts, and this is precisely what the District Court did, after all parties agreed that the proper method for presenting the matter of liability to the Court was on Cross-Motions for Summary Judgment.

Under the substantive law of Ohio, once it was established that the Bankrupt Stickler harbored an intent to defraud his creditors while operating his "Ponzi" type scheme, the Court could have stopped at this point and rendered judgment for the Respondent without even examining into Petitioner's knowledge of Stickler's intent.

Parenthetically, it should be pointed out that the reason the Judgment was granted to the Respondent by the District Court for $1,393,410.00, which monetary judgment was vacated by the Court of Appeals because "the

record does not demonstrate to our satisfaction that the cumulative total of $1,393,410.00 is the correct basis for judgment" (Petitioner's Brief, page 26), was because all the evidentiary facts on the issue of damages were before the District Court and there was no contest thereon. The District Court had before it, Stickler's records of his dealings with the Petitioner, as well as the reconstruction of the Bankrupt's financial affairs by the Certified Public Accountant. Since the Petitioner had previously declined to produce his records on the grounds of self-incrimination and did not dispute Respondent's exhibits, it was apparent that no further evidence would be forthcoming at a trial. The District Court, therefore, simply concluded, after deciding the question of liability, that to avoid the vain formality of a trial, the damage question should also be determined in the Summary Judgment.

CONCLUSION

It is respectfully submitted that the Petition for Writ of Certiorari in the United States Court of Appeals for the Sixth Circuit should be denied.

Respectfully submitted,

J. VINCENT AUG
S. ARTHUR SPIEGEL
Atlas Bank Building
Cincinnati, Ohio 45202
Counsel for Respondent.

Of Counsel:
WILLIAM H. NIEMAN
1005 Atlas Bank Building
Cincinnati, Ohio 45202